Bonded to interest rates

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PETALING JAYA: The strong demand for ringgit-denominated bonds among foreign investors who have shifted their portfolio to minimise risks from US president Donald Trump's policies will depend on the trajectory of central bank monetary policy going forward, say bond specialists.

Experts said that if the US Federal Reserve (Fed) decides to maintain the benchmark US interest rate while Bank Negara cuts the overnight policy rate (OPR) to support the domestic economy leading to widening yield differentials between US and Malaysian government securities (MGS), then investors chasing yields could shift their focus back to US treasuries (UST).

Bond yields represent the rate of return an investor receives on a bond upon its maturity. The Fed maintained the benchmark interest rate at the 4.25% to 4.5% range in the May meeting as the U

Bank Negara has also held the OPR steady at 3% in its recent meeting, but reduced the statutory reserve requirement (SRR) to 1% from 2% that resulted in the release of an additional RM19bil in liquidity into the banking system to support the economy.

However, despite the SRR decision, experts said there was still a high risk for an OPR cut in the second half of the year.

In comparison, the bond yield spread between the 10-year UST and the 10-year MGS stood at 0.84% on June 5, 2025, based on the Bond Pricing Agency Malaysia's (BPAM) data.

The 10-year UST on that date was at 4.40% and the 10-year MGS was at 3.56%. BPAM chief executive officer Meor Amri Meor Ayob told StarBiz several challenges could weigh on the ringgit bond market in 2025, with US monetary policy being one of them.

"UST continues to offer relatively higher yields compared to MGS, which may limit the appeal of MGS going forward.

"Moreover, with growing expectations that Bank Negara may cut the OPR in the second half of the year, yield differentials could widen further, potentially dampening foreign appetite for ringgit-denominated bonds.

"If the Fed maintains the current interest rates while Bank Negara cuts its OPR, the widening yield between the UST and MGS differential could reduce the attractiveness of Malaysian bonds to foreign investors and put pressure on the local ringgit," he added.

Meor Amri said another challenge lies in geopolitical uncertainties, especially around US trade policies under President Trump's administration, which could trigger market volatility and risk-off sentiment.

He said the recent surge in foreign demand for ringgit bonds in March and April 2025 was driven by uncertainty surrounding President Trump's flip-flopping tariff policies and his proposed "One Big Beautiful Bill". These developments have prompted some bond investors to reduce their exposure to UST and seek diversification in emerging market assets such as MGS, he noted.

Foreign net buying of Malaysian bonds surged to RM10.2bil in April this year compared to RM3.2bil in March, marking the second consecutive month of net inflows, despite "Liberation Day" tariffs government investment issues (GII), which attracted RM9.7bil of inflows (March inflow: RM3bil), as well as the shorter-term Malaysian Treasury Bills (MTB) and Malaysian Islamic Treasury Bills (MITB).

OCBC Bank (M) Bhd head of global markets Stantley Tan said the future demand from foreign investors for ringgit-denominated bonds would largely depend on a variety of macroeconomic and domestic factors.

Since the onset of 2025, he said global economic uncertainties have escalated, primarily due to rising geopolitical risks and inconsistencies in US tariff policies.

He said the imposition of substantial trade tariffs by the United States on its trading partners has disrupted global trade flows and increased the risk of a recession, particularly within the United States.

As trade negotiations continue, investors have also rebalanced their portfolios, reallocating investments towards emerging markets and economies less impacted by the tariff conflicts.

“On the domestic front, Bank Negara has reiterated its confidence in the resilience of Malaysia’s economy, which is fundamentally supported by robust domestic demand.

“However, the tone of the monetary policy committee (MPC) statement has shifted from cautious optimism to a neutral-dovish stance, reflecting the heightened external risks.

“In its latest meeting, the MPC reduced the SRR by 1% to provide additional liquidity support to the economy,” Tan said.

He said the ringgit bond market has started to price in the possibility of a policy rate cut in the coming months following the central bank’s slightly dovish tone. However, he said the risks to the current bond valuations remain, particularly if the economy proves resilient, prompting Bank Negara to hold policy rate steady, which could lead to a repricing of the bond market.

“A significant fiscal improvement by the government could mitigate the risk of a sell-off by easing the supply of MGS and GII in future issuances. Additionally, external risks may arise from the potential resolution of the US fiscal situation, which is currently under intense scrutiny by global investors. Should the US fiscal outlook improves, there is a possibility that investors may shift back to safe-haven assets, resulting in potential outflows from emerging markets including Malaysia,” Tan noted.

RAM Rating Services Bhd economist Nadia Mazlan said foreign investor appetite for Malaysian bonds may continue to be under pressure in 2025 amid continued heightened uncertainties arising from US protectionist trade policies.

She said the “risk-off” sentiments among investors at the start of the year and at the onset of the “Liberation Day” tariffs have already triggered a sell-off across both the equity and bond markets, Nadia said while there was some temporary reprieve from the postponement of higher reciprocal tariffs and signs of easing US-China trade tensions, which contributed to the net inflows in March and April, the continued unpredictability of US policies may still haunt global investors.

"The continued easing of market volatility recently may help support investor appetite for risker emerging market bonds in the short term, but it may be capped by the still-elevated uncertainties, especially as the 90-day pause on higher reciprocal tariffs is nearing its end.

"The potential future volatility from other proposed tariffs will likely leave foreign investors teetering on the edge," she said.

However, she said a tapering yield differential between the UST and MGS may help buoy some foreign demand for domestic bonds this year.

"With the Fed widely expected to reduce the federal funds rate in the face of slower economic growth, Bank Negara is expected to keep its OPR at 3%. This could help compress the UST-MGS yield spread, which should increase the appeal of Malaysian bonds and strengthen the ringgit this year.

"The country's strong economic fundamentals and prudent fiscal discipline also play important roles in making the country an attractive investment destination.

"Therefore, maintaining stable and effective domestic policies is essential to strengthening foreign investor confidence while ongoing improvements in fiscal metrics could further support demand for Malaysian bonds," Nadia added.